RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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September 6, 2000 **LETTER 1306**

THE PICTURE – They never make it easy for you. Under classic Dow Theory we have a clear case (see chart below). We received a bear market signal on September 23, 1999 -- and we received a re-confirmation of the bear market on February 25, 2000. Sure, we've had a lot of individual stocks take off during this period, and sure, we've had a lot of individual stocks decline since then. And even stranger, a few of the major Averages have ignored the Dow Theory bear signal. But the Transportation Average has been a major problem.

The Transports topped out in bear market fashion on May 12, 1999 at a value of 3783.50. The Transports have never been back. They did rally up to 2952.63 on April 12, 2000 -- but that was four months ago.

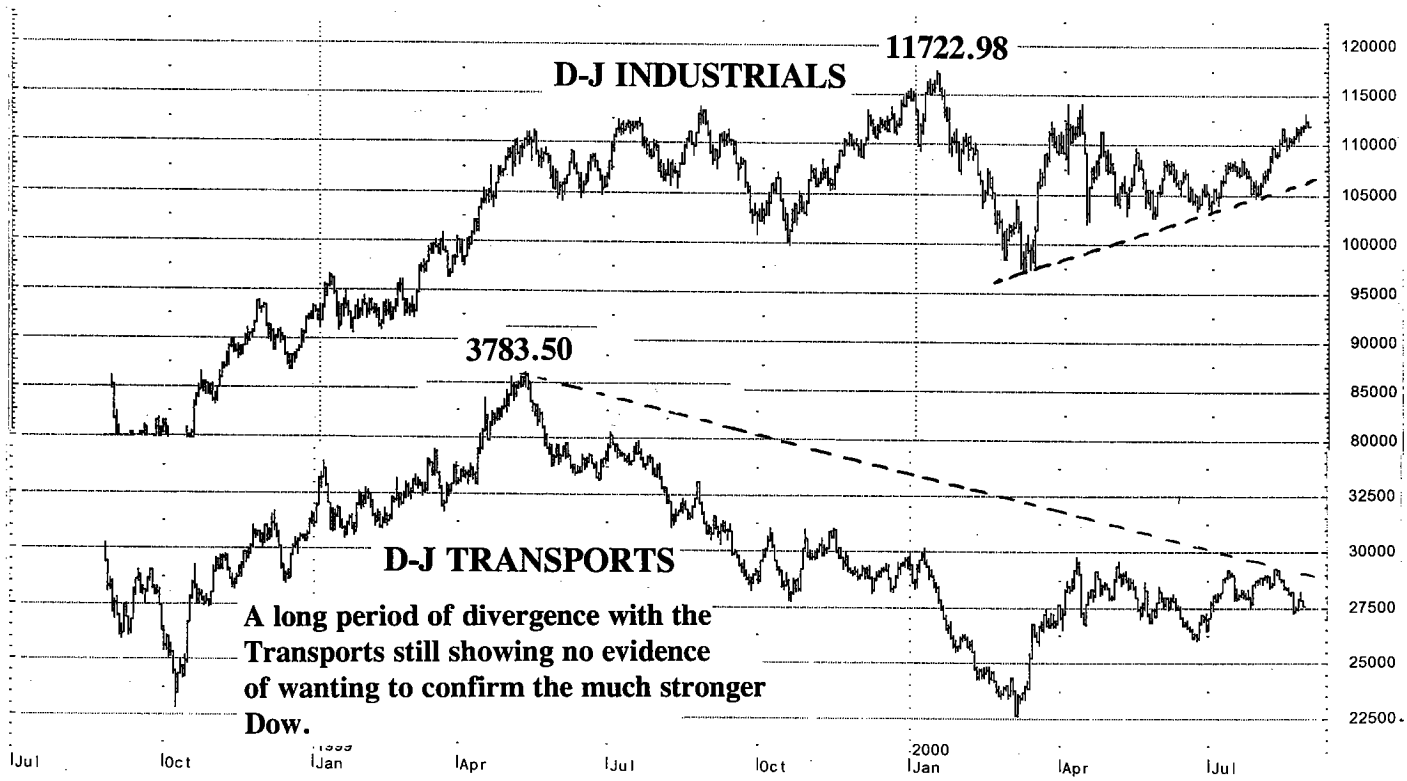
Today the Transports are at 2807, almost 1000 points below their May 1999 high -- for that matter, they are still 200 points below their April 2000 high. That hardly suggests anything close to a confirmation of the much stronger Dow.

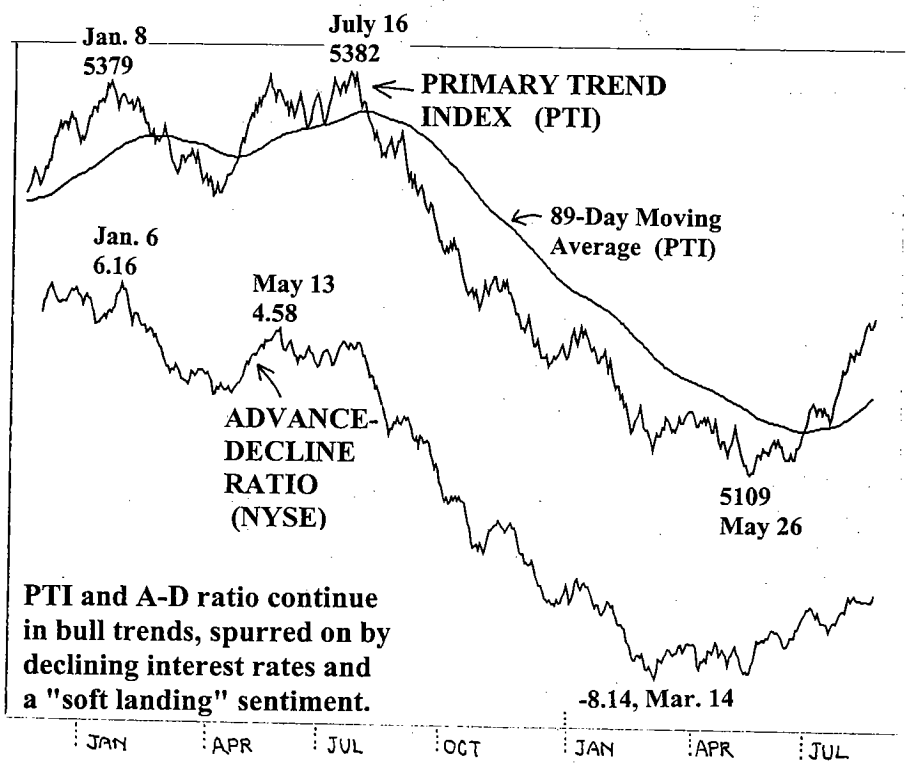
Aug 18, DJIA 11047.58; PTI 5193; A-D Ratio –5.11
Aug 25, DJIA 11192.63; PTI 5212; A-D Ratio –5.16
Aug 30, DJIA 11215.10; PTI 5218; A-D Ratio –5.05
***Dow Yield: 1.56%; *Dow Price/Earnings: 20.9**
***Dow Times Book Value: 6.83**
***Percentage of Undervalued Blue-chips: 15%**
***Gold 34-day MA: 282**
***(these figures as of 8/25/00)**

So from a classic Dow Theory standpoint, we're still in a bear market. Accordingly, orthodox Dow Theorists would give this market a wide birth, both from the standpoint of the price structure and from the standpoint of extreme over-valuation.

Yet we're seeing some action that has never been seen in any other primary bear market. And I honestly don't have any brilliant explanations for it. I have a few explanations, but they're just not brilliant.

The unorthodox action that I'm talking about is as follows: following the bear market signal and following the re-confirmation of the bear signal, we've witnessed new highs in the NYSE Composite, the S&P Financial Index, the D-J Utility Average, and the Value Line arithmetic average.





How could this happen? One explanation is that we now have more participants in this market, by far, than has ever been seen before in stock market history. And they're more bullish than ever before. That combination is bound to produce some "unusual" action.

On top of that, roughly a quarter of the issues listed on the NYSE are extremely sensitive to changes in interest rates. Bonds have been rising and interest rates have been dropping for most of this year. That alone can generate a large amount of upside pressure.

But at the same time oil, heating oil, and crude have been rising to levels that would ordinarily frighten the market, and so far, the market has ignored the situation.

In the end, all market action is simply a function of supply and demand. And this is where the Lowry's statistics come in. Lowry's monitors both the supply side and the demand side of the stock market. I've been reporting that the supply side (Selling Pressure) has been drying up.

Since April (which is when Selling Pressure began to decline) there's just been very little urge to sell. This means that those who want to buy must hit the offer price. When they do that, the price of the stock registers higher, and that's been the story of the advance so far - it's buyers paying the offer price and stocks creeping higher--while all along the sellers have been holding back on supply.

This kind of action doesn't make for a dramatic rise, but it does allow for a slow, dragging, rather deceptive rise.

On top of that we have only three months until election time. Historically, during the months prior to election, people tend to become optimistic. They're hoping the new president, whomever he may be, will prove to be a plus or at least an improvement over the old one (and the candidates, of course, are falling all over themselves with vote winning ideas for the coming year).

Primary Trend Index (PTI): In the end, we don't make money with explanations, we make money by taking **action.** This is the reason I developed my PTI. The PTI provides us with just one piece of information, but it is an extremely valuable piece of info - is the market moving up or is the market moving down?

After being in its bearish mode for about a year, the PTI on July 12 finally turned bullish by advancing above its 89-day moving average. On July 12 the Dow closed at 10783. Since the PTI "signal," the Dow has climbed 345 points or 4.3%. If you had bought the Diamonds (DIA) you wouldn't have made anything like a killing so far, but it remains to be seen how far the Dow can rally with the PTI now in its bullish mode.

Personally, as subscribers know, I have preferred to play the bonds and utilities rather than the stock market as a whole, and so far it's been a good move. The big averages are mixed but most are now up for the year, but the bond move has been spectacular with most bonds up 10% or more and on top of that they've paid out about 4%.

The crux of it, however, is that I was willing to take a very large position in bonds (because of the real return) whereas I was not willing to take a large position in stocks.

COMPLACENCY: We're at a rare juncture now, with extreme complacency taking over in both the stock market and the economy.

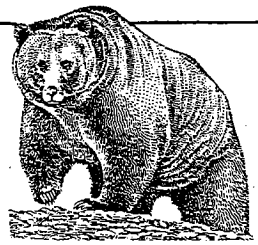
In the stock market we have the matter of overvaluation. The S&P is now selling at over 28 times earnings (the old danger area was 20). To justify today's prices, analysts are claiming (again) that this time "it's different," different because technology has allowed for heightened productivity. Furthermore, the new technology allows corporations to sense trouble and address that trouble much faster than was the case in the "old" pre-technology days.

One measure of complacency in the stock market is the VIX, which essentially tells us the price of put and call options. The VIX usually swings between a high of 30 and

a low of 20. Last week the VIX hit a low of 18.60, meaning that put options were selling very cheaply - in fact, they could hardly give puts away.

That tells us that traders saw almost no need at all to buy insurance against a decline. Buying puts is a way of making money (call it insurance) if the stock market suffers a major decline.

INVESTMENT POSITION: According to classic Dow Theory, the primary trend of the market is still bearish. Thus, the bear is in this box.



You can always find lists of stocks to buy. Every brokerage house has its own list. All the financial magazines have their lists. There is just no shortage of lists. I never use them. I don't think you can make money with them.

Early this year I suggested buying bonds. I also suggested buying utilities. Both of these suggestions have turned out well. Personally, I placed 85% of my entire assets in muni bonds and the rest, leaving some cash, in utilities. So far, I'd say the total return on the entire package is about 12%. That's good enough for me. The bulk of the income is tax free thanks to the munis.

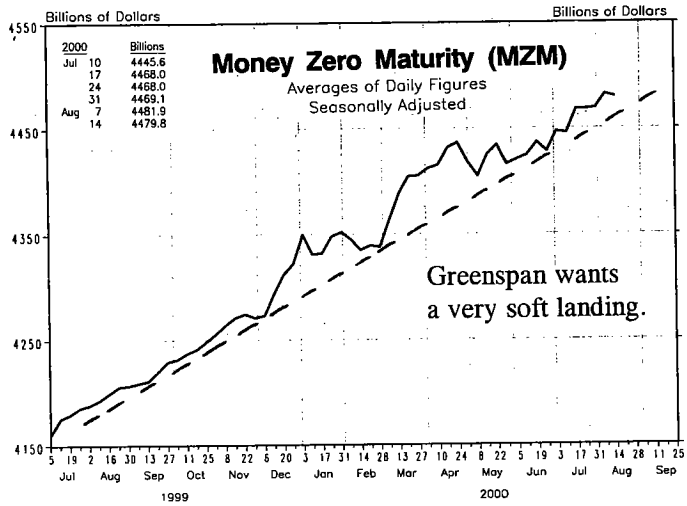
On July 12 my PTI, after being bearish for a year, turned bullish. At that point I suggested that those who wanted to "play" the PTI buy the proxies, SPY (S&P), QQQ (the Nasdaq 100), BBH (biotechs) or DIA (the Dow). All of these have risen but none have, so far, generated big profits. However, the PTI is still rising and increased profits could lie ahead.

The difference in the two choices is interesting. In buying the bonds and utilities I was buying what I felt was value in a flagrantly overvalued market. I was also buying income in a market that offers no income. As it turned out, bonds have outperformed stocks and the star group of stocks have been the utilities. So far, so good.

As for the proxies, these are speculations based on the thesis that as long as the PTI continues to rise, the direction of these proxies should be positive. And if the PTI rise is extended enough, these proxies should offer good profits.

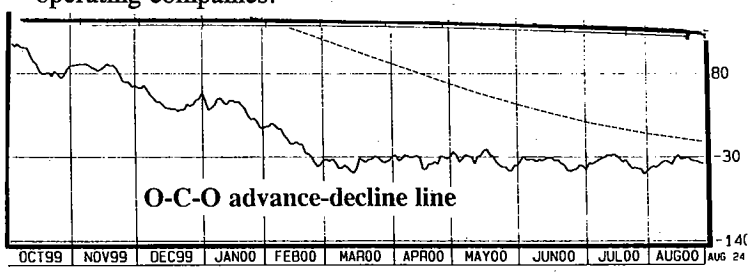
The only problem for me is that I don't have the stomach to put large amounts of money in sheer speculations. I have to buy values. I might buy say 500 Diamonds and 500 Spyders but unless there's a huge move to the upside, I'm not convinced that they're worth the risk. Sure the PTI is bullish, sure these should follow the PTI, but my stomach says, "If it's not a value with a return on the investment, I can't buy it, at least in any real quantity." And if I haven't the guts to buy in quantity, I'd rather keep the money in cash. I'll sleep better that way.

You know, it's a funny thing. Sometimes your stomach can be your best friend in this business. Every time I've made a large investment, I consult my stomach. If the investment makes sense, my stomach remains calm. If it's a stupid investment, my stomach will be rolling around like it's part of the deep sea. When that happens I usually rethink the situation and more likely than not, I get out. Every investment I make has got to pass the stomach test.



MZM or money of zero maturity (equal to cash) is the money supply that probably most closely correlates with the trend of the stock market. Here's the chart from the St. Louis Fed and I think the chart is self-explanatory. From June 12 to August 14 (latest figures) MZM has risen at a compounded annual rate of 6.8%. The message - there's no shortage of cash.

This is **Lowry's O-C-O advance-decline line.** O-C-O refers to operating-companies-only on the NYSE. This index filters out all the preferred stocks, the closed-end stocks, the closed-end bond funds. It deals with actual operating companies.



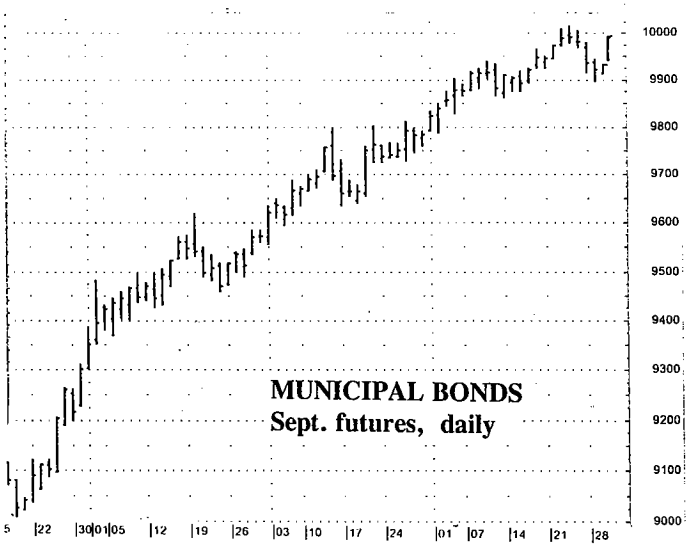
Note that the O-C-O advance-decline line hit a low in mid-March and has been moving sideways ever since. This means that for every operating company stock that has advanced since mid-March, another one has declined. No wonder it's been so difficult to make money in this kind of

a market, regardless of the better action of the main stock averages. (Lowry's 561 842 3514).

MUNICIPAL BONDS: Most of the states are generating large surpluses, and as a result they have been cutting back on the bonds they issue. On top of that, the ratings of many of the states have improved.

All this has not been lost on buyers of muni bonds. This chart shows the remarkable rise of muni bonds this year. Of course, the fact that for a while the tax free yield on muni bonds was about as high as the yield on 10 year T-Bonds also served to bring in muni buyers.

As a result, the performance of munis this year has been little short of spectacular. I've been recommending them over the last four months. I still like them. I compare their 5.6% tax-free interest with the 1.08% taxable yields on the S&P 500. The comparison is almost embarrassing.



NOTES & QUOTES: I've received so many comments on the *Business Week* interview with John Chambers, CEO of Cisco, that I wanted to reprint part of it here for subscribers who are not on the Internet and thus did not read my piece. Here's part of the Chambers Interview:

"This is truly the second industrial revolution, and it will change every aspect of people's lives. The changes that used to take place in a decade, when IBM or US Steel fell out of favor or when GM fumbled - can occur in one or two years. . . Companies that are successful will have cultures that thrive on change, even though the changes will make most people uncomfortable. In the end you just have speed, talent and branding. Those things may be the only differentiators.

"There will be nothing in the 10-year window except e-companies. That does not mean that brick-and-mortar will go away, but click-and-mortar will become the only means of survival. Secondly, keeping your finger on the pulse of your customer will become a requirement . . . The customer wins big time here, because everything gets cheaper forever. The ability to compare prices from 1,000 competitors rather than three will drive prices down. If you don't improve your productivity, you're out of business. We believe the average price of consumer products in Britain alone will come down 10% to 15% in the next three years. The price of a car will come down 30%.

"I will put my jobs anywhere in the world where the right infrastructure is, with the right educated workforce, with the right supportive government. I can do that today with the technology we have, but I can't do it socially. I don't know how to manage that yet. You give me a decade and I will be able to do it extremely well. That's what people haven't gotten yet. This is global competition like we've never seen before.

"The Internet is not just a nice productive tool. This is about survival."

Russell Comment: This is the force for world deflation. Chambers says this is the age of "survival". You either get with the program, or you're history. I believe it, and I take what Chambers says very seriously.

* *

I still have about 2,000 subscribers who evidently want no truck with computers - or they just plain hate them. And I can understand that. Computers or PCs are unreliable, they freeze, they crash, and they are complicated. Now MSFT and Compaq have joined to bring out the iPAC Home Internet Appliance IA-1, a $199 home computer that is designed for people who hate computers. Actually, Compaq doesn't even want to call it a computer, they call it "the Internet in a box."

The catch is that if you buy this box for $199 you have to sign up for three years at $21.95 a month for Internet access. Otherwise, they'll charge you a stupid $599 for the thing alone. The iPAC is simple, you plug it in, it doesn't have to boot up, and you get instant entrance to the Internet, and you can also get e-mail. In the meantime Gateway will be coming out later this year with an improved edition of the original I-opener, another non-computer box.

The main thing about the iPAC is its simplicity. And for those of us who struggle with computer (Windows) crashes, unexplainable glitches and the general orneriness of computers, the iPAC may make sense.

* *

I think it was in 1960 when I taught what I believe was the first course in technical analysis of stock trends ever taught anywhere. I taught at the New School for Social Research

in New York. It was a bitter cold winter, and the class was every Thursday for four hours. I got sick about two-thirds of the way through the course, and a friend of mine had to help me get through the last third (my voice was gone).

While there, I also took a course on managing a motion picture theatre (I'm not exactly sure why I took that course except that I have always loved the movies). One thing struck me in that course, and it was this (the fellow who taught the course was actually the manager of a New York "art theatre"). He said, "I always read the *New York Times* book section. This gives me a smattering of background so that I can talk to the patrons about what's going on in new books and literature. Of course, I don't have time to read any of these books but who's to know."

That struck me as both clever and devious. And it was the only thing that I brought home from the course. However, it started me in a life-long habit of reading the book sections of the *New York Times*, the *LA Times* and more recently the *San Diego Union*.

In my younger days, I was a glutton for fiction. I spent many a summer reading Tolstoy, Dostoievski, Mann, Shakespeare, Hemingway, and on and on. Today I find it hard to read fiction. I spend my time reading non-fiction. The reason-- in my mind I always feel that I can dream up fiction as good as the writers. But in non-fiction I learn. Everything you want to know is in books. It's all there, sometimes hidden, but it's all there (I now include the Internet in that statement). To my mind, the ultimate handicap, the ultimate horror would be to be illiterate. And yet, so many people are. To my mind, being illiterate is to cut yourself off from 95% of the world's intelligence. You might as well be, well, half blind.

* *

Here's a shocker for my Jewish subscribers. According to figures from *Newsweek* (August 21), the percentage of Jews marrying other Jews has now dropped to 42%. What's happening is that slowly but surely the percentage of Jews in the US population is dropping towards 1%. In the mid-30s the Jews as a percentage of the US population hit a high of 3.7%. It is now just above 2%. Interestingly, there are 5.7 million Jews in the U.S. There are 4.7 million Jews in Israel.

Israel is in what I think is a long-term precarious position. The Orthodox Jews want to make the nation a theocracy. Right now 67,000 Jews are state-sponsored scholars. They live separate lives, and they do not serve in the army (a small percentage volunteer). How this can be after the Holocaust is beyond me? All other Jews go into the military for a term -- men and women. The problem: average number of children in non-orthodox families - two. Average number of children in orthodox families - seven. This is a prescription for potential major trouble.

Me --I'd never live in a theocracy, and I've never been fascinated with any organized religion. I go by that old saying, "I dumped religion and found God."

Most of the Founding Fathers of America were religious men, and they founded a remarkable new nation "under God." The Great Seal of the US has deep religious significance. But the Founding Fathers were wise, and they were specific in wanting a government in which religion and the state were entirely separate. They wanted no religious sect or group running the nation.

* *

As older subscribers know, I'm a magazine nut. I must receive 50 different mags. This month, the fashion mags are amazing. *In Style* looks like the Manhattan telephone book; it has 760 pages. *Harpers Bazaar* has 550 pages. *"W"* is huge with over 500 super-large pages. I feel sorry for the postmen and women who have to deliver these paper monsters.

* *

I have a huge book called "Chronicle of the 20th Century." The book traces every day of the 1900s with actual newspaper clips. What's particularly fascinating are the clips of early businesses. In the old days, there were no IPOs. These pioneer business men did it the hard way.

Examples: *Dec. 2, 1901: Gillette to Market a Replaceable Razor. An American business man name King Camp Gillette who in 1895 patented a new model of razor, is planning to market the gadget in the coming year. The razor is shaped like a hoe, and its double-edged blade is designed to be used just once or until dull, discarded and replaced with a new one. William Nickerson, the only employee of the Gillette Co., resolved the manufacturing problems. The new Gillette model, with its double-edged, replaceable blades, is designed to be both a safety razor as well as more efficient. Yet it is very difficult to predict what kind of reception the male public, despite the decreasing popularity of beards, will give the new type of razor, which has a very thin, but sharp replaceable blade."*

Feb. 18, 1902. "Charles Tiffany Dies. Charles Lewis Tiffany began his business career in a country store. He ended it as New York's most fashionable jeweler. Four days after his 90th birthday, Tiffany died today, laden with honor and wealth, socially prominent and generous with his money. Five generations of the Tiffany family lived in Massachusetts. Tiffany's father lent him $1,000 to establish a stationary store in New York called Tiffany and Young, later transformed into Tiffany & Co., a treasure house full of silver, gold and gems.

REITs, UTILITIES: I've discussed and advised buying utility stocks and many of these have done well. I particularly like the action of Southern Co. (SO), Dominion

(D) and Teco (TE), Con Ed (ED), Detroit Elect. (DTE), and Texas Util. (TXU).

Quite a few subscribers have asked me why I don't recommend REITs, many of which pay nice dividends and many of which are doing well. I prefer utilities to REITs, but maybe I'm being unfair.

I think the reason I haven't recommended REITs goes back to my experience with real estate during the Depression. Real estate is illiquid, and during the Depression real estate prices totally collapsed. Furthermore, I learned to be very suspicious of real estate profit and loss statements.

But I guess times have changed, and the real estate industry has become a lot more honest.

A big plus for the REITs should be the REIT Modernization Act (RMA) signed into law by Clinton as part of a larger bill in mid-December, 1999. This bill becomes effective in 2001; it will allow REITs to own subsidiaries, which in turn can provide new services to tenants, and this will allow additional avenues of income. RMA will also reduce the annual distribution of taxable income required of REITs from 95% to 90%. Presumably, this will allow REITs to pare down debt and develop properties.

Standard & Poor's like these REITs, and I won't argue with them: Vornado Realty (VNO); Boston Properties (BXP); Chelsea GCA Realty (CCG); Spieker Properties (SPK).

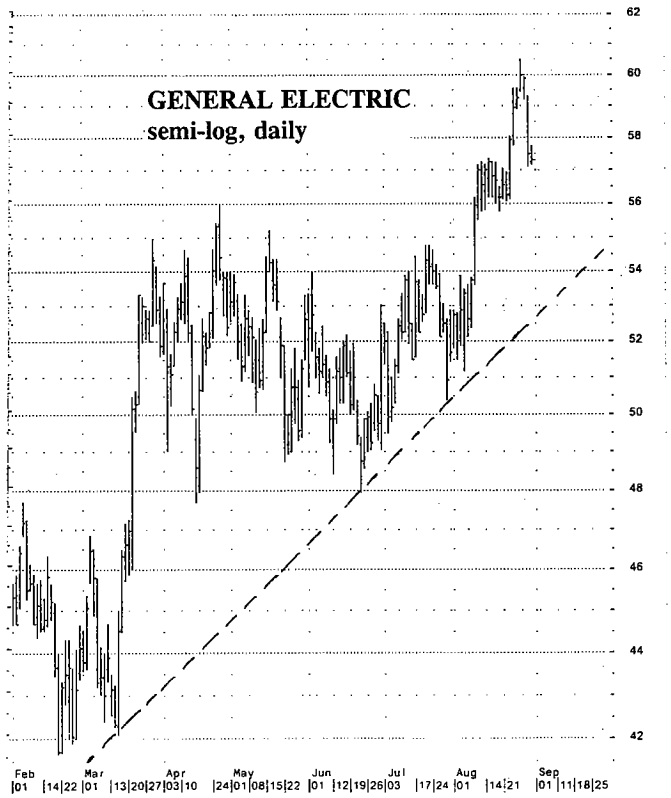
Russell Comment: With it all, I still prefer utilities to REITs.

GENERAL ELECTRIC: In this business everyone is looking for the magic indicator, the bellwether that will lead them to the promised land. After you've spent a decade or so looking for the "pot of gold," you sadly conclude that there's no such thing.

The nearest thing I've found to be the magic answer is my own PTI. But is there a single stock that is a good indicator of the way the market is heading?

It seems to me that if there is such a stock, it's GE. GE has, I believe, about a 95% correlation with the trend of the broad market. On that thesis, I show here a daily chart (semi-log) of GE going back to the beginning of the year.

GE has been in a clear rising trend since late-February. I've drawn a bullish trendline, and this trendline will not be violated unless GE drops below 53 1/2 (54 by the end of September). So as long as this bellwether holds above the trendline, color the trend bullish.



LATE NOTES: The "leading indicators" have declined (only slightly but still they declined) for three consecutive months. The markets are clearly taking this as almost a guarantee that the economy is moving into "soft landing" mode.

The bonds love it, and they celebrated by surging to new highs. On August 31 the D-J Utility Average advanced to a new high. This is powerful medicine, and the stock market followed suit, rallying strongly.

Is there anything wrong with the picture? There is from a Dow Theory standpoint. What's wrong is that the Transports are not only failing to confirm – they've actually been diverging (going in the opposite direction from the Dow).

What could lie ahead? A strong possibility would be as follows: the Dow advances to a new all-time high, above 11722.98, and the Transports refuse (by a wide margin) to confirm. In the face of the flagrant non-confirmation, the stock market tops out and a major bear market leg unfolds.

Late news: the unemployment rate has moved up to 4.1% and factory orders in July dropped a record 7.5%. Consumer confidence dropped in August. It all points to a "soft landing," that is, unless the soft landing turns into a "hard landing." The bonds love the picture, but the Transports most definitely **do not.** The Transports reflect sales and shipping. What the Transports are telling us may not be that pleasant.

NEXT MAILING: September 27, 2000